protected by the federal Constitution". It would have been well to have elaborated the comment on the decisions in which race discriminations had been sustained. It is hardly enough to say that "such legislation must have its limitations".[28] Further argument might well have been adduced to sustain the position that the denial of equality of legal freedom occasioned by the ordinance under review was substantial and not formal merely, and that the possibility that the restriction might promote the public peace was too visionary and insignificant to justify so serious an interference with the legal equality of the races.

The decisions of the Supreme Court on various forms of race discrimination do not support the statement of Mr. Justice Harlan that the "Constitution is color-blind",[29] but they establish that the propriety of race separation is conditioned on giving to each race equality or something approaching equality of legal opportunity, even though they do not receive identical treatment. The Supreme Court's studies in chiaroscuro may not suit the taste of those who insist that the state must be allowed to discriminate between the races as it pleases, or not to discriminate at all. But to those who are aware that differences of degree affect all questions of the police power,[30] the Supreme Court will not seem guilty of inconsistency. Its decisions have shown leniency towards the sensibilities of the white race in the Southern states so long as those sensibilities found expression in laws imposing only ephemeral or intermittent separation of the races or in laws specifically aimed against miscegenation. But when steps are taken to impose continuous and permanent barriers to the freedom of the members of either race to settle their abode where they will and can, the Supreme Court has wisely refused to accept fictions of equality in the face of the obvious fact of inequality.

T. R. P.

ACCUMULATED CORPORATE EARNINGS AND THE INCOME TAX.—For a proper interpretation of the federal income tax laws, their constitutional setting must always be kept in mind. The Pollock case,[1] held that Congress was not authorized to levy a tax on income, whether derived from realty or from personalty, because such was, in effect, a direct tax on the property itself and, therefore, unconstitutional under Article 1, § 9 requiring direct taxes to be apportioned according to population. To obviate this difficulty, the Sixteenth Amendment was adopted February 25, 1913. Under the authority of this Amendment, the Federal Income Tax Law of 1913[2] was passed, taxing "income arising or accruing from all sources in the preceding calendar year", but for the year 1913 only that "accruing from March first". Corporations were made subject to the normal tax on much the same terms as individuals, and dividends from corporations were expressly included

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[28] 38 Sup. Ct., at p. 20.

[29] Plessy *v.* Ferguson, *supra,* footnote 5, at p. 559.

[30] *Cf.,* Holmes, *J.,* in Rideout *v.* Knox, *supra,* footnote 20, at p. 372: "It may be said that the difference is only one of degree; most differences are, when nicely analyzed. At any rate, difference of degree is one of the distinctions by which the right of the Legislature to exercise the police power is determined."

[1] Pollock *v.* Farmers' Loan & Trust Co. (1895) 158 U. S. 601, 15 Sup. Ct. 912.

[2] 38 Stat. 166, c. 16.

as income. In the recent case of *Lewellyn* v. *Gulf Oil Corporation* (3 C. C. A. 1917) 245 Fed. 1, where a holding corporation received from its subsidiaries dividends declared subsequent to March 1, 1913, out of earnings accumulated prior to that date, the court upheld an income tax assessment based on the full value of the dividends. No money changed hands, the whole operation requiring only a book transfer. In its simplest terms, the case is merely one of cash dividends to an individual shareholder.[3]

It is submitted that the court, perhaps by following too closely the theory of corporate entity, failed to grasp the true state of affairs, with resulting injustice to the taxpayer. It is easy to say that the earnings belong to the corporation before and to the shareholder after the declaration of a dividend, but that is merely a convenient way of stating a result. What is really meant is, that the rights of the shareholder in reference to the money are different after distribution than they were before. Who owns property, on a final analysis, but individuals? Any property may be tied up in such a way that the owner may not be able to use it as he pleases, but that only means that his rights in reference to it are qualified or different. Take the case of a partner in relation to the partnership assets, or of a tenant in common to the unpartitioned property. Again, it is said that the legal title to trust property is in the trustee, but is that anything more than a technical way of stating the qualified rights of a *cestui que trust?* Only after stripping the relationship of the shareholder to the corporate assets of all philosophical conceptions, which only becloud the issue, is it possible to consider his liabilities under the income tax laws.

Just what is meant by "income" is very difficult to say; the term as used in the Sixteenth Amendment must necessarily be broad. The statute says "gains, profits and income" "arising or accruing * * * in the preceding calendar year". This, without much doubt, includes gains made on the sale of capital assets which have increased in value —the difference in value between two given points of time.[4] Obviously the extent of time is an important element,—in the statute under consideration so much increase *per year.* This does not mean that appreciation in value of capital assets is taxed; that is not being done under the present law as administered.[5] But when the whole or part of the appreciation has been realized, then the tax is levied. Even if the whole sum is assessed for the year when received, that does not signify that it is all income of that year. The taxpayer is merely paying retroactively on the income for the back years which have

[3]In 18 Columbia Law Rev. 63, the case of Towne *v.* Eisner (D. C. 1917) 242 Fed. 702 was considered. In that case the court held that stock dividends declared out of earnings accumulated before March 1, 1913 were to be taxed as income when received. Two questions were plainly involved: whether or not stock dividends were income under the statute, and, if so, were they taxable if declared out of money earned prior to March 1, 1913. Since the printing of that note, the Supreme Court has decided (Towne *v.* Eisner, U. S. Sup. Ct., Oct. Term 1917, No. 563), as the Review contended, that stock dividends were not to be taxed as income under the 1913 law. Plainly the second question presented in the Towne case in the lower court is no longer open for discussion; but the instant case raises the same point as applied to cash dividends.

[4]Montgomery, Income Tax Procedure for 1917, at p. 18 *et seq.*

[5]Letter to Collectors, August 14, 1914. Corporation Trust Co. Income Tax Service § 260.

escaped the tax. But the income of 1912 or any prior year is not subject to the tax, for, until the Sixteenth Amendment went into effect, March 1, 1913, Congress was not authorized to tax incomes. As a result, the value of the property as of March 1, 1913 is taken as a starting point and only increase in value subsequent thereto can be considered.[6] What is to be done in the case of a holder of a share of stock? The court in the instant case says, in effect, that the accumulated earnings of the corporation shall not be allowed to increase the value of the shareholder's assets; that the earnings belong to the corporation; presumably, that the value of the share is only the nominal capital value.[7] It is submitted that this method of reasoning is highly artificial and that the result reached is unsound. Surely the capital assets of the individual as of March 1, 1913 are different from the mere nominal value of the share. Just what the true value is may be somewhat difficult to say—perhaps the shareholder's undivided share of the total corporate assets, or else the market value of the shares. Whichever criterion is the correct one, that value represents the taxpayer's capital assets as of March 1, 1913, and any sum returned in dividends which depreciates such capital value is a return of capital, and it is unconstitutional to tax it as income.

The authorities other than federal are not of much influence in the present case. Either the wordings of the statutes are different, or the taxing power was not limited as was that of Congress before the Sixteenth Amendment.[8] It is, however, essential to examine the various federal cases to see how they have lined up on the question, prior to

[6]Under the Corporation Excise Tax Law of 1909, 36 Stat. 112, c. 6, it was decided that, where shares were held over a number of years, only increase in value subsequent to the time when the law went into effect could be taxed as income to the corporation. Gauley Mountain Coal Co. *v.* Hays (C. C. A. 1915) 230 Fed. 110.

[7]Under the Corporation Excise Tax Law of 1909, *supra,* footnote 6, where a corporation held shares of another corporation, their market value as of January 1, 1909 was taken as the value on which to measure increases for the purpose of ascertaining income, Cleveland, *etc.* Ry. *v.* United States (C. C. A. 1917) 242 Fed. 18, which is clearly an authority *contra* to the view taken by the court in the instant case. The same is also true of Gauley Mountain Coal Co. *v.* Hays, *supra,* footnote 6.

[8]In Trefry *v.* Putnam (Mass. 1917) 116 N. E. 904, the situation was much the same as in the instant case, for a constitutional amendment similar to the Sixteenth Amendment had been adopted in 1915, and the court upheld the tax levied. The Wisconsin cases, Van Dyke *v.* Milwaukee (1915) 159 Wis. 460, 146 N. W. 812, 150 N. W. 509; State *ex rel.* Sallie F. Moon Co. *v.* Wisconsin Tax Com. (Wis. 1917) 163 N. W. 639, must be read in connection with the special wording of their statute which says income "received". However, it would seem that this difference is only apparent and that the cases are in accord with the instant decision. But see the dissenting opinion in State *ex rel.* Pfister *v.* Widule (Wis. 1917) 163 N. W. 641, at p. 643. In an English case, Gramophone & Typewriter, Ltd. *v.* Stanley [1906] 2 K. B. 856, [1908] 2 K. B. 89, it was held that earnings of the subsidiary corporation were not income of the holding corporation until declared as dividends; apparently to be income when they were declared. This case in no wise attacks the stand taken in the present writing, as it is admitted that there must be separation of appreciation before the tax can be levied. If it is all taxed as income when received, then, it is submitted, the tax is retroactive; however, a Parliament, unrestricted by a constitution, may make its law as retroactive as it pleases.

the final decision by the Supreme Court, which may come at any time now. The case of *Lynch* v. *Turrish*,[9] also in the circuit court of appeals, is cited by the court in the instant case and disregarded as distinguishable. It is submitted that it is clearly *contra*, and that the decision of the highest court on it will be decisive of the instant case. The facts were, that all the capital of a corporation was invested in land which had increased in value prior to March 1, 1913, but such value had remained stationary, subsequently, until sold. The money was distributed as dividends, and the court held that the recipient did not have to pay an income tax on any part of the sum received. The case is sound, for the distribution was one of capital as of March 1, 1913. But were the rights of the shareholder in reference to this increase in value any fuller than in reference to the earnings collected by the corporation in the instant case? If the undivided share of the corporate assets or the market value of the share, as of March 1, 1913, was the capital of the shareholder on that date in the former case, why is not the same true in the latter? From the point of view of the corporation, the increase in the value of the land was increase in capital assets with, as yet, no separation, while the accumulated earnings were clearly separated income. From the point of view of the shareholder, however, the increase in corporate assets resulted in an increase in his capital assets in one case, if it did in the other.[10]

STATE REGULATION OF COMMUTATION RATES.—With the growth of railroad industry, there has been an increasing tendency on the part of state legislatures to regulate intrastate rates, and the course of this regulation has been and will continue to be profoundly affected by the attitude of the courts towards such legislation. In this respect, the recent case of *Pennsylvania R. R.* v. *Towers* (1917) 38 Sup. Ct. 2, and *Lake Shore & Michigan Southern Ry.* v. *Smith*,[1] decided eighteen years earlier, are of particular interest as furnishing the basis for an inference as to the possible development of the law during the period embraced within the dates of the two decisions. In the earlier case, the Supreme Court decided, by a divided bench, that a Michigan statute requiring railroads to furnish mileage books, good for two years and usable by the purchaser or his family, at a

[9](C. C. A. 1916) 236 Fed. 653. Lynch *v.* Hornby (C. C. A. 1916) 236 Fed. 661, was decided at the same time and in the same way. In that case only part of the property holdings in the corporation—timber lands—was sold, and the money returned as dividends. Southern Pac. Co. *v.* Lowe (D. C. 1917) 238 Fed. 847 is directly in line with the instant case. The decision which was overruled by the instant case, Gulf Oil Corporation *v.* Lewellyn (D. C. 1916) 242 Fed. 709, is well reasoned and brings out clearly the issue now to be decided by the Supreme Court.

[10]A later statute clearly recognizes the defect of the 1913 law; 39 Stat. c. 463, Title I, pt. 1, § 2(a) "the term 'dividends' * * * shall be held to mean any distribution * * * by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred thirteen". § 2 (c). "For the purpose of ascertaining the gain derived from the sale * * * of property, real, personalty, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis of determining the amount of such gain derived."

[1](1899) 173 U. S. 684, 19 Sup. Ct. 565.